BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of )
)
LANCASTER COLONY CORFORATION )
AND AUGUST BARR, INC. )

For Appellants: Richard L. Greene
Attorney at Law

For Respondent: Jean Harrison Ogrod
Counsel

## O P I N I O N

These appeals are made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Lancaster Colony Corporation against proposed assessments of additional franchise tax in the amounts of $3,301.05, $6,220.29, $20,906.82, and $13,553.44 for the income years ended June 30, 1972, June 30, 1973, June 30, 1974, and June 30, 1975, respectively, and on the protest of August Barr, Inc., against proposed assessments of additional franchise tax in the amounts $543.53, $409.56, and $2,540.28 for the income years ended June 30, 1972, June 30, 1973, and June 30, 1975, respectively.

The sole issue presented by these appeals is whether the appellant corporations were engaged in a single unitary business with their affiliated corporations during the appeal years.

Lancaster Colony Corporation (Lancaster) has a number of operating divisions and is the parent corporation of numerous subsidiaries. Each division or subsidiary manufactures and/or sells one or more products in the following areas: electronic and industrial glass components; consumer, florist, and restaurant glassware; decorative accessories; gifts and candles; kitchen utensils; aluminum cookware; rubber and plastic housewares; rubber and vinyl automotive products; athletic balls and play balls; toys; industrial gloves; and salad dressing and sauces. August Barr, Inc. (August), is a Lancaster subsidiary which manufactures and sells vinyl athletic and play balls. It also purchases and resells vinyl balls made by Barr, Inc., another Lancaster subsidiary.

In all, Lancaster had seven divisions and fourteen subsidiaries during the appeal years. One of Lancaster's divisions provided management and business services to Lancaster affiliates. The design department designed the annual report and also provided packaging design services for any of the smaller affiliates which do not have separate design departments. The traffic department provided advice on distribution methods for Lancaster and the smaller affiliates which did not have their own traffic departments. The industrial engineering department also provided services to affiliates as needed. "The insurance, employee benefit and financial services were used by all companies because of economic benefits." (App. Br. at 9-10.) Each company was billed for these services based on its ability to pay.

There was substantial interlocking of officers and directors among all the corporations. John J. Gerlack and his son, John B. Gerlack, were key officers and directors of every corporation. Lancaster officers and/or directors controlled every board except one where they constituted one-half of the board.

Every subsidiary and division made intercompany sales and/or purchases. Intercompany sales averaged approximately 13% of total net sales for those divisions and subsidiaries shown by appellant to have made such sales during the appeal years. Essentially 100% of the

sales of two companies, Jackson Corporation and Colony Cookware, were intercompany. Intercompany purchases averaged approximately 12% of the cost of sales for the appeal years. One-half of the operating divisions and subsidiaries sold to more than one of their affiliates and five of these sold to four or more of their affiliates.

There was no centralized purchasing, advertising, or employee benefit plan which covered the entire group.

Lancaster, August, and three other Lancaster affiliates filed separate California franchise tax returns during the appeal years. Upon audit, respondent determined that Lancaster was engaged in a single unitary business with its affiliates and issued notices of proposed assessment based on combined report and apportionment procedures. After considering appellant's protest, respondent excluded one corporation, T. Marzetti Company, which manufactures and sells salad dressings and sauces, from the unitary group. The proposed assessments were revised and proposed overpayments for some years were computed.

When a taxpayer derives income from sources both within and without this state, its franchise tax liability is measured by its net income derived from or attributable to sources withinthis state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a single unitary business with affiliated corporations, the income attributable to California sources must be determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).)

The existence of a unitary business may be established under either of two tests set forth by the California Supreme Court. In Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942), the court held that a unitary business was definitely established by the presence of unity of ownership, unity of operation as evidenced by central purchasing, advertising, accounting, and management divisions, and unity of use in a centralized executive force and general system of operation. Later, the court stated that a business is unitary if the operation of the portion of the business done within California is dependent upon or contributes to the operation of the

business outside California. (Edison California Stores, Inc. v. McColgan, supra; 30 Cal.2d at 481.)

Respondent's determination is presumptively correct and appellant bears the burden of proving that it is incorrect. (Appeal of John Deere Plow Co. of Moline, Cal. St. Bd.. of Equal., Dec. 13, 1961.) Each appeal must be decided on its own particular facts and no one factor is controlling. (Container Corp. of America v. Franchise Tax Bd., 117 Cal.App.3d 988 [173 Cal.Rptr. 121] (1981), affd., -- U.S. -- [77 L.Ed.2d 545] (1983).) Where, as here, the appellant is contesting respondent's determination of unity, it must prove by a preponderance of the evidence that, in the aggregate, the unitary connections relied on by respondent were so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist.

Appellants concede that unity of ownership existed, but contend that the unities of use and operation did not exist between or among the affiliated corporations and that Lancaster and its divisions and subsidiaries were separate businesses, not dependent upon one another. We find, however, that the record shows such a degree of mutual interdependence among the affiliated corporations that we must conclude that they were engaged in a single unitary business. That both contribution and dependency exist among these corporations is demonstrated clearly by centralized services, intercompany product flow, and integration of executive forces.

Although many commonly owned companies may have some centralized services, they are frequently in areas such as accounting, budget review, and tax preparation, which show little more than the appropriate oversight an investor would give to an investment. These types of services, when not shown to result in any substantial mutual advantage, are not generally significant indicators of unity. In contrast, the services performed by Lancaster's corporate staff included, but went beyond, mere administrative functions. The design, traffic, and industrial engineering departments provided services which directly contributed to the operations of the affiliates which used them. Appellants admit that the affiliates' use of insurance, employee benefit, and financial services resulted in benefits to the group. Additionally, the companies paid for the centralized services not on the basis of their use, but their ability to pay, resulting in the more profitable companies subsidizing the provision of services for the less profitable.

The contribution and dependency demonstrated by this situation is clear.

The intercompany product flow also shows the interdependence of these affiliates. The sale and/or purchase of both raw materials and finished goods pervaded the network of affiliates. Not all of these transactions occurred on a regular basis, but if one affiliate lacked something due to special circumstances, another affiliate apparently filled the need whenever possible. The intercompany sales and purchases provided definite links which connected even diverse business activities into a single web of vertically and horizontally integrated operations, each part contributing to or depending upon some other part. This creates a strong impression of unity which appellant has done nothing to dispel.

Interlocking officers and directors can be significant indicators of unity. (Chase Brass & Copper Co. v. Franchise Tax Board, 10 Cal.App.3d 496, 504 [87 Cal.Rptr. 239], app. dism. and cert. den., 400 U.S. 961 [27 L.Ed.2d 381] (1970).) We believe that the extensive integration of executive forces here is significant, not simply because of its existence, but particularly in the context of the integration shown by the centralized services and intercompany product flow. The, coordination and involvement of this integrated executive force was clearly an important factor in the high degree of interdependency achieved by these numerous affiliates. This is not a situation where executives were appointed as mere figureheads, but one where the integrated executive force directed the welding of diverse activities into a single unitary business.

We must disagree with appellants' statement that the facts show that appellants and their affiliates and divisions are not engaged in a single unitary business. To the contrary, we find that the facts clearly demonstrate the existence of a unitary business. We must, therefore, sustain the action of the Franchise Tax Board.

## O R D E R

Pursuant to the views expressed in the opinion of the board on file in these proceedings, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND 'DECREED, pursuant to section 25667 of the Revenue and 'Taxation Code, that the action of the Franchise Tax Board on the protest of Lancaster Colony Corpora-tion against proposed assessments of additional franchise tax in the amounts of $3,301.05, $6,220.29, $20,906.82, and $13,553.44 for the income years ended June 30, 1972, June 30, 1973, June 30, 1974, and June 30, 1975, respectively, and on the protest of August Barr, Inc., against proposed assessments of additional franchise tax in the amounts of $543.53, $409.56, and $2,540.28 for the income years ended June 30, 1972, June 30, 1973, and June 30, 1975, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of October ,1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins , Chairman

Ernest J. Dronenburg, Jr. , Member

Conway H. Collis , Member

William M. Bennett , Member

Walter Harvey* , Member

*For Kenneth Cory, per Government Code section 7.9